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No. A-559

IN THE

# Supreme Court of the United States

October Term, 1982

CITY OF TORRANCE,

*Appellant,*

*vs.*

WORKERS' COMPENSATION APPEALS BOARD OF THE STATE OF CALIFORNIA; STATE COMPENSATION INSURANCE FUND,

*Appellees.*

## REPLY BRIEF.

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## REPLY BRIEF.

This Reply Brief by City of Torrance (City) is necessitated by the invective, innuendo and outrightly misleading statements made by appellees. This appeal concerns a relatively simple issue — whether, after City (and numerous other public entities) paid millions of dollars to State Fund for insurance covering claims of injured workers — the City can be required to pay a second time for such claims. A second payment would be required because the California Legislature has retroactively abrogated State Fund's obligation to honor its insurance contracts. As a result of this statutory amendment, State Fund will retain $70 million dollars which it had collected to pay claims of injured workmen.

In responding to City's Jurisdictional Statement, appellees and amici curiae on their behalf make erroneous and misleading contentions:

First, because State Fund earns a profit and, in certain managerial respects, resembles a private insurance carrier, State Fund represents it is not a state agency. State Fund hopes this Court will ignore the specific holdings of the California courts for almost half a century that "the State Compensation Fund is an agency of the State." *Gilmore v. State Comp. Ins. Fund*, 23 Cal. App.

2d 325, 329, 73 P.2d 640 (1937). State Fund further believes this Court will disregard the monopoly granted by the Legislature to State Fund for selling workers' compensation insurance to public entities in California.

Second, State Fund argues there is no impairment of City's contract of insurance. State Fund asserts that although it contractually pledged itself to "pay promptly and directly . . . any sums due", it need not pay any cumulative trauma claims made against the City despite City's payment of insurance premiums for such coverage. Simultaneously, State Fund argues it may keep the reserve of $70 million established to pay for such claims.

Finally, appellees contend State Fund's refusal to pay claims in accordance with its insurance policies does not constitute a substantial impairment of its contract. In doing so, they confuse two different juridical relationships: (1) the *contractual* relationship between City and State Fund, with (2) the *status* relationship between City, as employer, and its employees. State Fund, however, fails to cite any decision concluding that a legislature has an unrestricted right to retroactively abrogate *contract* rights simply because it may change compensation benefits for injured employees.

**1. State Fund Is a State Agency Which Has a Monopoly in Providing Workers' Compensation Insurance to Public Entities.**

State Fund misleadingly asserts there is "no authority for the proposition that public agencies must buy *all* of their insurance from the State Compensation Insurance Fund or that they even have to be insured with appellee." (State Fund Br. at 3). Regrettably, that statement is a misleading and overbroad generalization. As indicated in City's Jurisdictional Statement, this case involves *only* workers' compensation insurance. Accordingly, it does *not* involve marine insurance *nor* credit insurance *nor* even medical malpractice insurance. As to workers' compensation insurance, the California Legislature granted State Fund a monopoly. See Ins. Code § 11870. A public entity must insure itself with State Fund or be self-insured. *Id.* Despite State Fund's misleading assertions to the contrary, State Fund has a statutory monopoly.

State Fund further desires to avoid the constitutional prohibition against impairing contracts and the rulings of this "Court [which] has held a governmental unit to its contractual obligations when it enters financial or other markets." *Energy Reserves Group, Inc. v. Kansas Power and Light Co.*, 51 U.S.L.W. 4106, 4109 (1983). State Fund misleadingly represents it is on "an equal footing with all other compensation carriers." (Br. at 4). That representation is false. California courts for almost half a century have held State Fund is a direct arm of the State of California: "The State Compensation Insurance Fund is an agency of the State." (*Gilmore v. State Comp. Ins. Fund*, 23 Cal. App. 2d 325, 329, 73 P.2d 640 (1937)). Notably, State Fund cites *Gilmore* (Br. at 4, n. 6); however, it ignores the express holding in representing the contrary to this Court. Numerous other cases also conclude State Fund is a state agency.[1] The conclusion of the California courts requires no extensive analytical support. Even a cursory review of State Fund's extraordinary powers renders that conclusion inescapable.[2] Similarly, a glance at its management structure (who are California civil executive officers)[3] or

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[1]See *e.g. Yedor v. Ocean Acc. & Guar. Corp.*, 85 Cal. App. 2d 698, 701, 194 P.2d 95 (1948); *DeCampos v. State Comp. Ins. Fund*, 75 Cal. App. 2d 13, 17, 170 P.2d 60 (1946).

[2]The Legislature has meticulously regulated State Fund and granted it extraordinary powers, even for a state agency. State Fund may establish accounts in the State Treasury. Ins. Code § 11800.1. The California Treasurer, moreover, is custodian of its securities. Ins. Code § 11788. The California Controller may similarly establish special ledger accounts on State Fund's behalf. Ins. Code § 11800.2. To protect the directors of State Fund, the Legislature has created a special immunity against personal liability. Ins. Code § 11772. The Legislature has similarly established certain immunities as to types of claims and limited State Fund's liability in cases of suit. Ins. Code §§ 11801, 11771. No private insurance company has such a panoply of legislatively created rights and immunities.

[3]Structurally, the Governor appoints State Fund's five directors; its chairman is statutorily mandated to be California's Director of Industrial Relations, another state official. Ins. Code § 11770. The chief managerial employees of State Fund are legislatively designated as state civil executive officers. Gov't. Code § 1001. The Fund's manager even files a special oath with the Secretary of State. Ins. Code § 11786.

its employees who are protected by civil service precludes any other conclusion.[4]

**2. Legislative Abrogation of State Fund's Contractual Commitments After Receipt of Premium Payments Constitutes an Impairment of City's Insurance Contracts.**

State Fund deposited in its coffers premium payments made by City and numerous other public entities. Those payments were made in consideration of State Fund's pledge to pay all claims assessed against its insureds. State Fund now asserts, however, it may retain this 70 million dollar reserve while it dishonors its pledge. State Fund furthermore contends the City (and other public agencies) must pay for employee claims after having previously paid for such coverage; however, it asserts "appellant's contracts are not impaired." (Br. at 10).

In asserting City's contract has not been impaired, State Fund unjustifiably attempts to confuse two separate juridical relationships: (1) State Fund's *contractual* obligation to provide insurance to City; with (2) City's *status* relationship as an employer of its employees. As described in the Jurisdictional Statement (at 15-16), the employer-employee relationship is one of mere status. "[T]he right to, and liability for, compensation established by the [workers' compensation] act are not founded upon contract, but are statutory rights and duties arising from the employer-employee relationship, and are imposed by the law as incidents of that status." (*Argonaut Mining Co. v. Ind. Acc. Com.*, 104 Cal. App. 2d 27, 29, 230 P.2d 637 (1951)). Permissible modifications of the *status* relationship between employee and employer do not establish a constitutionally acceptable basis for

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[4]State Fund employees take a state oath which is filed with the State Personnel Board. Ins. Code § 11873(b), Gov't. Code §§ 18153, 18155. The Board disciplines such employees through civil service regulations. Ins. Code § 11873(b), Gov't. Code § 18703. Furthermore, promotions of employees are subject to competitive examinations. Ins. Code § 11873(b), Gov't. Code §§ 18936, 18950. They are members of the public employees retirement system. Ins. Code § 11873(b), Gov't. Code § 20000 *et seq*. Furthermore, they receive state-provided medical, hospital and dental care. Ins. Code § 11873(b), Gov't. Code §§ 22751 *et seq*., Gov't. Code §§ 22754, 22950.

upsetting the separate *contractual* undertaking between City and State Fund. As this Court has held, Article I, Section 10 of the Constitution precludes impairments of *contract*, not changes in *status* relationships. *See Usery v. Turner Elkhorn Mining Co.*, 428 U.S. 1, 15, 96 S. Ct. 2882, 2892, 49 L. Ed. 2d 752 (1976).

After receiving millions of dollars in premiums and creating an enormous reserve, State Fund now refuses to pay claims under its *contract* based upon the statutory amendment. Other than the decision of the state court in the instant case, neither State Fund nor any of its amici curiae cite a single decision *from any jurisdiction* approving that anomalous result. To the contrary, insurance carriers may not constitutionally disavow contractual obligations based upon legislative changes. To hold otherwise would interfere with a municipality's vested rights or otherwise impair the obligation of contract owed by an insurance company to its insured.[5] As stated in one decision cited by an amicus on behalf of State Fund:

> "[T]he company's contract under its policy is to pay *whatever workmen's compensation benefits the legislature may have seen fit to impose upon the insured municipality*. When the policy of coverage is so construed, there is no question of interference with vested rights, or impairment of the obligation of a contract, presented here." (*Douglas County v. Industrial Commission*, 275 Wis. 309, 81 N.W.2d 807, 821 (1957)).

State Fund has conceded that it would have been required to honor its contractual commitments to pay for the Atkinson claim but for the legislation. *City of Torrance v. Workers' Comp. Appeals Bd.*, 32 Cal.3d 371, 376, 185 Cal. Rptr. 645, 647 (1982). It nevertheless attempts to base its position of refusing to pay upon supposed implications from the policy. Under the express

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[5]In a similar decision cited by State Fund itself (Br. at 18), the court stated the same principle more colorfully:

> "If, under the facts, an employer is stuck with compensability requirements, its insurance carrier is as deeply mired. That is this case. The carrier, on the risk cannot disespouse itself from its premium-paying relative by a divorce . . ." *State Insurance Fund v. Industrial Commission*, 16 Utah 2d 269, 399 P.2d 208, 210 (1965).

terms of the policy,[6] however, State Fund agreed "to pay promptly . . . any sums due for compensation." Moreover, State Fund is the party "primarily liable . . . to pay compensation, if any, for which [City] is liable". Furthermore, State Fund agreed to be bound by . . . "all awards rendered against [the City]." State Fund conveniently attempts to disregard each of its express obligations in this case.

In the case at bar, an award has been rendered against the City. Changes in the *status* relationship of City to its employees do not abrogate State Fund's *contractual* duty to honor those claims. Under the express terms of the policy, State Fund is "bound by" any award of benefits. Furthermore, State Fund, not the City, is "primarily liable" for satisfying the award. State Fund, however, argumentatively desires to disassociate itself from the award made against the City. In essence, State Fund wants to change the language of the policy. By striking the term "Insured" and replacing it with "State Fund," State Fund might be able to argue that its responsibility is so limited. That, however, is not the language of the policy.[7]

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[6]In relevant part, the policy states:

> "State Compensation Insurance Fund . . . does hereby agree . . . (1) *To pay promptly and directly* to any person entitled thereto under the Workmen's Compensation Laws . . . any sums due for compensation for injuries, . . . ; *to be directly and primarily liable* to employees covered by this Policy . . . to pay the compensation, if any, *for which the Insured is liable* . . . ; and the Fund shall in all things be bound by and subject to the orders, findings, decisions or awards *rendered against the Insured* under the provision of Workmen's Compensation Laws of the State of California." (App. p. 33, n. 4). (Emphasis added).

[7]By applying general principles of interpretation applicable to insurance policies, the aberrant position of State Fund's argument is highlighted. But for this case, California conclusively presumes that the insurance carrier is liable to the employee "under the same circumstances and to the same amount as the employer." (*U.S. F. & G. Co. v. Indus. Acc. Com.* (1925) 195 Cal. 577, 580, 234 P. 369). Moreover, but for this case, it has been settled in California for over half a century that an insurer, by entering into an insurance contract with an employer, "[t]he insurer, assuming the risk voluntarily . . . stands in his place."

At bottom, after having paid insurance premiums to State Fund, City is being obliged to pay a second time. The City's taxpayers paid $1.5 million for insurance coverage. Those same taxpayers are now legislatively being compelled to also pay the claims of Atkinson's heirs although State Fund is "primarily liable." That is a clear impairment of City's rights.

### 3. The Payment of Claims by an Insured After It Has Paid for an Insurer to Assume the Risk of Such Claims Constitutes a Substantial Impairment of Contract.

In an attempt to sidestep the issue whether City's contract of insurance was impaired, State Fund asserts City should have foreseen a legislative change because "[s]imilar rules . . . were already evident in other states." (Br. at 15). Whether other states have different workers' compensation insurance programs is irrelevant. City and numerous public entities paid their premiums in California. State Fund issued the policies and received the premium payments in California. As noted above (at 5), State Fund has conceded that the policy would have continued to cover City's employees but for the legislation. The existence of other types of workers' compensation statutes in other states is irrelevant to the question whether City's contract with State Fund has been unconstitutionally impaired by the California Legislature. Assuming the experience of other states is relevant, it is apparent that almost half of them — from Arizona to New York — require an apportionment as between insurers of the same employer. Despite State Fund's sweeping generalization concerning the vast majority of jurisdictions, it is evident most states have not ac-

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(*Employers' L.A. Corp. v. Indus. Acc. Com.* (1918) 177 Cal. 771, 775, 171 P. 935). Both of these conclusive presumptions are predicated upon the conclusive statutory presumption that "insurer will be directly and primarily liable to any proper claimant for payment of any compensation for which the employer is liable." (Ins. Code § 11651). Even were the insurance policy ambiguous (which it is not), any such ambiguity would have to be construed against the insurer. (*Holt Rubber Co. v. American Star Ins. Co.*, 14 Cal.3d 45, 59, 120 Cal. Rptr. 415. (1975)).

cepted the position advocated by State Fund.[8]

We have read with care every citation filed in opposition to City's Jurisdictional Statement. *Not one* permits an insurer to avoid its contractual obligations based upon a subsequent change in the employer-employee benefit structure. *Not one* requires an insured employer to pay claims based upon changes in the workers' compensation law after having paid premiums for such coverage. *Not one* permits an insurer to retain the reserves established from premium payments so as to require the insured to also pay the inevitable costs of such claims.

Appellees contend that the legislative history indicates the shift in liability from State Fund to its insureds resulted from the desire to make California consistent with other states. No decision, however, establishes consistency as a constitutionally permissible basis for impairing City's insuring agreements with State Fund.

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[8]In contrast to the states cited by State Fund, other states conclude apportionment as between the insurers of a single employer or between employers is appropriate and required where acts of different employers or during different periods contribute to an injury: *Derwinski v. Eureka Tire Co.*, 407 Mich. 469, 286 N.W.2d 672 (1979); *Doherty v. Grow Construction Company*, 14 A.D.2d 957, 221 N.Y.S.2d 9 (1961); R.I. Gen. Laws § 28-34-9; *Yokum v. Lester*, 544 S.W.2d 234 (1976, Ky.); *Dunbar Fuel Co. v. Cassidy*, 100 N.H. 397, 128 A.2d 904 (1957); *Employers' Cas. Co. v. United States Fidelity & Guar. Co.*, 214 Ark. 40, 214 S.W.2d 774 (1948); *Quinn v. Automatic Sprinkler Co.*, 50 N.J. Super. 468, 142 A.2d 655 (1958); *Merton Lbr. Co. v. Industrial Commission*, 260 Wis. 109, 50 N.W.2d 42 (1952); *Andrus v. Boise Fruit & Produce Company*, 84 Ida. 245, 371 P.2d 256, 262 (1962); *Continental Casualty Co. v. Industrial Commission*, 8 Ariz. App. 289, 445 P.2d 846, 847 (1968); *Tri-State Insurance Co. v. Industrial Commission*, 151 Colo. 494, 379 P.2d 388, 389 (1963); *Mund v. Farmers' Cooperative*, 139 Conn. 338, 94 A.2d 19 (1952); *Castille v. Trinity Universal Insurance Company*, 177 So.2d 647 (La. App. 1965); *J.E. Greene Co. v. Bennett*, 207 Tenn. 635, 341 S.W.2d 751 (1960).

Moreover, although certain states impose liability on the last employer, those states have no rule regarding apportionment between insurers of that employer: Montana, Texas, New Mexico, Missouri, Alabama, Iowa, South Dakota. Other states have not reached any clear decision as to which employer or which insurer is responsible: Nevada, North Dakota, Ohio, Washington, West Virginia, Wyoming, Hawaii, Nebraska and Mississippi.

Moreover, a less biased view of the legislative history indicates that the amendment was caused by a desire to "punish" those public entities who refused to continue their insurance arrangements with State Fund.

Ignoring the question of State Fund's excessive rates and substandard performance, the Legislature was keenly aware of the refusal of public entities to renew coverage. (Assem. Com. on Finance, Insurance and Commerce, Interim Hrg. on Assem. Bill 155 (Jan. 12, 1977), pp. 369, 374, 204-205). Moreover, despite State Fund's representations about its " 'long and impressive record of substantial dividend payments' " (Br. at 4), the Legislature knew State Fund had failed to make such payments. (*Id.* at 211). The Legislature, however, did not repeal the statutory provisions granting State Fund a protected monopoly nor censure State Fund for bad claims practices. Instead, it transferred liability from State Fund to these former insureds which it estimated to be approximately $52.7 million. (*Id.* April 27, 1977 at p. 4). With the accumulation of interest and earnings, the total reserve now amounts to $70 million. (State Fund Annual Report 1981, p. 14, n. 4). How that sum may be dissipated by State Fund is constitutionally irrelevant.

State Fund's unsupported argument that the prior legislation created a "procedural morass" requiring legislative correction cannot withstand analysis. As indicated in the Jurisdictional Statement (at 20, App. 57), apportionment requires a maximum of only two litigants — the public entity and State Fund because of its monopoly in providing such insurance coverage to public entities. That obvious fact was found by the Workers' Compensation judge. *Id.* Accordingly, it is obvious why no appellate tribunal has questioned the self-evident truth there was no procedural morass justifying the direct impairment of City's contract with State Fund.

Finally, State Fund asserts the amount of the dollars involved is insignificant since the percentage of cumulative trauma claims amount only to 12½% of all claims filed. (Br. at 24). Moreover, it asserts that as employees leave City's employ, City's financial responsibility will decrease. (*Id.*) Those considerations are irrelevant to resolution of the Atkinson and other claims.

Assuming the risk is so low and the cost so minimal, State Fund should carry no substantial burden in honoring its contractual responsibilities.

### 4. Conclusion.

For the reasons stated above, City of Torrance respectfully submits that the appeal should be heard on the merits and decision of the California Supreme Court be reversed.

Respectfully submitted,

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